

# LEARN THE ABCs OF INVESTING

*Ask Questions*

*Beware of Fraud*

*Call the Investor Hotline*

Robin Carnahan  
Secretary of State





## A Message from Missouri Secretary of State Robin Carnahan

For more than 80 years, the Securities Division in the Office of the Secretary of State has been protecting Missouri investors from securities fraud. Today, the Securities Division remains committed to its mission of investor protection and education.

To fulfill this mission, we take enforcement action against any person or company violating the Missouri Securities Act or engaging in unethical practices against Missouri investors. We also register securities offerings, stockbrokers and investment advisers. If you need to file a complaint or obtain information about an investment, stockbroker or investment adviser please call our office at 1-800-721-7996.

Part of being a successful investor is being an educated investor. Most investments involve a degree of risk. Understanding investments and their inherent risk will help you meet your investment goals.

The Securities Division provides this Investment Guide as a tool to educate Missouri's citizens and to assist investors in protecting their hard-earned money. I hope you find the guide useful.

Sincerely,

A handwritten signature in black ink that reads "Robin Carnahan". The signature is written in a cursive, flowing style.



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### **Missouri Investor Bill of Rights**

#### **When you invest, you have the right to:**

1. Receive information from a firm about the work history and background of the person handling your account, as well as information about the firm itself.
2. Receive responsible investment recommendations designed to meet reasonable expectations consistent with your personal objectives, time horizon, risk tolerance and other factors.
3. Receive complete information about the risks, obligations, benefits, history and costs of any investment before investing. The firm or its representative should provide full disclosure of the commissions, sales charges, maintenance and service charges, transaction or redemption fees and penalties related to the various securities or variable annuities.
4. Receive a clearly defined process for raising and resolving a complaint including alternatives available to you if the firm is unable to resolve a dispute to your satisfaction. You have the right at any time to move your account to another representative or a new investment firm whenever you wish in a simple, timely and efficient manner.
5. Receive clear, accurate, timely and easy to understand account forms, agreements, statements, trade confirmations and other communications from your investment firm.
6. Receive a thorough explanation of the terms and conditions of transactions you undertake from your investment representative.
7. Access your funds in a timely manner and receive information before investing regarding any restrictions or limitations on access.
8. Clear descriptions of the firm's policies and procedures for protecting the privacy of your non-public, personal information.
9. Receive information from the Securities Division of the Secretary of State's Office pertaining to the employment, complaint and disciplinary history of an investment firm or its representatives and receive information about any security to find out if it is permitted to be sold in Missouri, or to file a complaint.
10. Regulators and advocates who put serving and protecting the investor first.

### What Are Securities and Who Regulates Them in Missouri?

Securities are stocks and bonds, limited partnerships in real estate, oil and gas offerings, investment contracts or an investment in a common enterprise with an expectation of profit to be derived from the managerial efforts of others. Almost any type of profit-making venture that depends on the efforts of the seller to realize a profit could be a security and must be registered with the Missouri Securities Division or qualify for an exemption from registration.

The Missouri Securities Division of the Office of the Secretary of State is responsible for protecting investors by ensuring compliance with securities laws. This responsibility includes enforcement of the law when violations occur and the regulation of investment sales through registration of securities, broker-dealers, agents, investment advisers and investment adviser representatives.



**Note:** The terms “securities” and “investments” are used interchangeably throughout this publication.



### What Should I Consider Before I Invest?

#### Setting Your Investment Goals

Before investing, ask yourself, “**What do I want to accomplish through my investments?**” For most investors, the following investment goals or objectives, or some combination of these, provide an initial answer:

**Safety (low-risk):** This objective reflects a conservative investment philosophy with minimal risk of loss of the original investment (the “principal”). This approach carries little risk, but may generate only a modest return.

**Income (low- to moderate-risk):** An “income” objective is achieved by purchasing investments that provide a stream of income through regular payments, which may or may not decrease the invested principal. These fairly conservative investments are designed to generate regular income payments or tax savings.

**Growth (moderate- to high-risk):** This category refers to investing for long-term growth or appreciation in market value. Growth investments carry a higher risk than either safety or income-oriented investments. Growth investments generally provide little or no dividend income. Although this approach is targeted toward long-term growth, short-term losses may occur.

**Speculation (high-risk):** Speculative investments carry a higher-than-average possibility of loss. This objective often includes short-term trading of new or unproven companies' stocks or options. Although there is the possibility of higher and faster rewards, speculative investments are high risk, meaning there is also the possibility of larger and faster losses of some, or your entire principal. These investments are not recommended for novice or conservative investors.



**Remember, the more money you want to make from your investment, the more risk you must be willing to take. Risk means that you may lose all or part of your principal. If a high level of risk makes you uncomfortable, select your investments accordingly.**

## *Learning the ABCs*

### *Investment Basics to Remember*

Before you invest, consider your complete financial situation, looking at both your current and future needs. In general, investors should avoid higher-risk investments unless they have a steady income, adequate insurance and readily available cash reserves in case of a loss.

### *There Is Always Risk*

When you purchase securities, there will always be a risk of loss. For this reason, it is usually not in your best interest to invest all of your money in any one security. If safety of investment is one of your goals, you and your investment professional should explore a number of different investments for your account to increase safety.

The greater the “promise” of return, the riskier the investment. Before you invest, it is important that you investigate the company, the salesperson and the investment by asking questions, checking references and calling the toll-free investor hotline at 1-800-721-7996. You should thoroughly understand the investment before you invest. Ask questions and write down the answers for future reference.

### *To Minimize Your Risk, Read the Prospectus*

Reading the prospectus is the best way to get detailed, precise information about a securities offering.

A prospectus is a written document that provides all material information about an offering of securities. The prospectus is the primary sales tool of the company that issues the securities (called the issuer) and broker-dealers that market the offering for the issuer (called underwriters).

- ❖ **No matter how you choose to invest your money, there will always be a degree of risk involved.**
- ❖ **Risk and return go hand in hand. Higher returns mean greater risk, while lower returns promise greater safety.**

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In addition, a prospectus is a legal document that protects the issuer and underwriters because it serves as written proof that you were given all of the material facts as they are set out in the prospectus. For that reason, you should be certain that you understand the disclosures made to you and that all verbal explanations are consistent with the disclosures contained in the prospectus. **A prospectus MUST be given to you at the time of the sales presentation, not after you have already purchased the product.**



- ◆ Do not invest in anything you do not fully understand.
- ◆ Do not invest more than you can afford to lose.

### How do I Choose an Investment Professional?

#### *Selecting an Adviser or Broker to Assist in Your Financial Planning*

Typically, the person who will handle your account will be referred to as an investment adviser representative or agent. These individuals are employed by or through a registered investment adviser firm or broker-dealer. This person will be your primary point of contact regarding your account.

Advisers and brokers are required to pass qualification examinations to determine if registration should be granted with the Securities Division.

Additionally, individuals who perform this type of work are required to complete the Uniform Securities Application which contains public disclosure information for any state in which the individual may already be doing business. This disclosure will include previous complaints, arbitrations or regulatory actions.

#### *Consider These Characteristics*

The following is a list of characteristics and qualifications you should consider when choosing your investment professional:

- Easy to talk to.** You should feel comfortable with your investment professional. The more he or she knows about your financial situation and goals, the better your account will be served.
- Doesn't pressure you.** You need to keep in mind that your investments must please you, not just your investment professional. A good investment professional will take time to find the investment strategy that is best for your individual needs.
- Listens carefully.** Tell your investment professional when/if you are uncomfortable with a certain degree of risk or a certain type

**Before you hire an investment professional, contact the Securities Division at 1-800-721-7996 to confirm that the professional and the firm are properly registered. Additionally, we can tell you if the individual has any public disciplinary history in any state.**

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of investment. It is his or her job to find out as much information as possible about your needs and wants.

—**Explains things until you understand.** The securities business is very complicated and can be difficult to understand. A good investment professional will provide you with information and will take as much time as necessary to explain a proposed transaction.

—**Is registered with the Securities Division and does not have a history of customer complaints.** The Securities Division keeps a register of Missouri investment professionals and has their reported disciplinary histories on file. While an occasional customer complaint may be inevitable, an investment professional with a history of customer complaints should be avoided. To check on your investment professional's registration and history, call the Securities Division and ask about your investment professional directly.

### *New Account Forms*

Once you have chosen an investment professional, you will be asked to fill out new account forms. These forms usually require



you to give personal financial information and to state your investment objectives. It is very important that you provide accurate responses. Under Missouri law, your investment professional is obligated to only recommend transactions believed to

be suitable based on your financial needs and objectives.

**Keep in mind that you are paying for the services of an expert whose advice can only be as good as the information it is based on. Be sure to fill in all the blanks, marking through those that do not apply, and sign the form. NEVER sign a blank form.**

### **What Basics Should I Know About Investing?**

#### *The Exchanges*

The New York Stock Exchange (NYSE) lists more than 1,800 stocks and over 2,400 corporate bonds. However, many more stocks and bonds are offered in other markets. These other markets include the American Stock Exchange, Pacific Stock Exchange, Boston Stock Exchange, Chicago Board Options Exchange and NASDAQ.

#### *Types of Investments*

Stocks represent a share of ownership in a corporation. A corporate bond is a security that represents a debt owed by the corporation to the bondholder, but does not include the ownership privileges of stock. Stocks and bonds are the staples of many investment portfolios. As an investor, it is important to have a clear understanding of just what these securities can and cannot be expected to offer by way of a return.

#### **COMMON STOCK**

Common stock, also called common shares, capital shares or capital stock, represents units of ownership in a public corporation. Purchasers of common stock are granted specific rights that may include the right to:

- ❖ Vote at stockholders meetings
- ❖ Sell or otherwise dispose of their stock
- ❖ Purchase additional shares of common stock issued by the corporation at the first opportunity
- ❖ Share pro rata with other common stockholders in any dividends distributed to common stockholders

## *A Guide for Missouri Investors*

- ❖ Receive annual reports and inspect the corporation's books and records
- ❖ Share in any assets remaining after creditors are paid if the corporation is liquidated.

A corporation may be authorized to issue more than one class of stock. For example, one class of common stock might have enhanced voting rights. Holders of this class would likely pay a higher price for their shares. Usually any additional classes of stock being offered are designated as “preferred stock.”

### **PREFERRED STOCK**

Preferred stock gets its name from the preferences granted to its owners. These preferences may include the payment of dividends and distribution of assets before that of common stockholders in case of liquidation.

Preferred stock offers relative safety of income, but usually has a more modest growth potential than common stock.

You should discuss with your broker the various types of preferred stock available and whether they fit into your investment objectives.

### **How Stock Is Valued**

**Stock is often referred to as having par value, book value and market value.**

#### **Par Value**

**Par value is an arbitrary value set by the company at the time of issuance and is of little concern to most investors.**

#### **Book Value**

**Book value is calculated by dividing the total net assets of the company by the number of shares outstanding.**

#### **Market Value**

**The price at which shares of stock can be bought and sold is called the market value. Shares that are not publicly traded, however, will have no market value.**

## Learning the ABCs

### BONDS

While a share of stock represents partial ownership (equity) in a company, bonds represent debt payable by a company to the bondholders.

A company issuing a bond agrees to repay the amount borrowed plus a specific rate of interest at an agreed time, the maturity date. On the face of a bond certificate is the name of the company issuing the bond, the serial number, the principal amount of the bond, the rate of interest and the maturity date.

The quality of a bond usually can be determined by its rating. Ask your broker for the rating of a particular bond you are interested in. If the issuer is creditworthy, bondholders can expect regular interest payments on specific dates. As with any investment, there is a risk that you may lose all or part of your investment should the company issuing the bonds go bankrupt. However, bondholders' claims in a bankruptcy must be satisfied before any payments are made to preferred or common stockholders.

A common area of misunderstanding for those who invest in bonds is the inverse relationship between interest rates and bond prices by which an increase in interest rates leads to a decline in bond prices. When interest rates are higher than current yields on bonds, demand tends to shift away from the bond market and into the bank market. Bondholders then sell their bonds to take advantage of the more favorable interest rates, creating a downward pressure on bond prices.

Bonds are issued by federal, state and local governments, and by business corporations. U.S. government bonds are considered the safest, since the U.S. government has the highest credit rating of any borrower. State and local governments offer what are commonly referred to as "municipal bonds," which have the advantage of a federal tax exemption on interest paid.

**Interest on bonds must be paid in good times or bad, like any other debts, which may be an attractive feature for investors seeking greater capital security and assured income.**



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### **Bond Calls**

Most bonds have a feature that gives the issuer the option to call the bond at any time. This means that if you buy a bond that pays 15% interest and interest rates fall, the company that issued the bonds can state that it is buying back your bonds and will not pay any interest after the call date, so that it can reissue the bonds at a lower interest rate. The company only pays the principal amount plus any interest that accrued by the call date. The company is not liable for payment of additional interest after the call date.

This rule prevents bondholders from delaying cashing in the bonds in order to stay at the higher rate of interest as long as possible. However, the company is not required to notify bondholders of the call individually, but only to advertise with public notices in certain financial publications. The bonds are generally called the day after an interest payment, and investors are usually not aware that the bonds were called until the next interest payment is due.

### **MUTUAL FUNDS**



When you put money into a mutual fund, it is pooled with money from other investors to create much greater buying power than

you would have investing on your own.

Since a fund can own hundreds of different securities, its success is not dependent on how one or two holdings perform. Plus, the fund's professional managers keep constant tabs on the markets, trying to adjust the portfolio for the strongest possible performance.

A mutual fund makes money in two ways: by earning dividends or interest on its investments and by selling investments that have increased in price. The fund distributes, or pays out, these profits (minus fees and expenses) to its investors.

#### **There Are Three Main Categories of Mutual Funds:**

- ◆ **Stock Funds:** also called equity funds, invest primarily in stocks
- ◆ **Bond Funds:** invest primarily in corporate or government bonds
- ◆ **Money Market Funds:** make short-term investments to keep their share value fixed at \$1

## *Learning the ABCs*

Most funds diversify their holdings by buying a wide variety of investments that correspond to their category. A typical stock fund, for example, might own stock in 100 or more companies providing a range of different products and services.

### **VARIABLE ANNUITIES**

Variable annuities have become part of the retirement and investment plans of many Americans. Variable annuities are essentially a combination of mutual funds and insurance products. But, variable annuities are very complex products and often have higher fees, commissions and restrictions on access to your money. Before you buy a variable annuity, you should know some of the basics, and be prepared to ask your insurance agent, broker, financial planner or other financial professional many questions about whether a variable annuity is right for you.

Before buying any general annuity, you should find out about the particular annuity you are considering. Request a prospectus from the insurance company or from your financial professional, and read it carefully. The prospectus contains important information about the annuity contract, including fees and charges, investment options, death benefits and annuity payout options.

**Ask your investment professional to compare the benefits and costs of the annuity to other variable annuities and to other types of investments, such as mutual funds.**

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### VARIABLE ANNUITY CHARGES

You will pay several charges when you invest in a variable annuity. Be sure you understand all the charges before you invest. These charges will reduce the value of your account and the return on your investment. Often, they will include the following:

- ❖ Surrender charges
- ❖ Mortality and expense risk charges
- ❖ Administrative fees
- ❖ Underlying fund expenses
- ❖ Fees and charges for other features



**Remember: Variable annuities are designed to be long-term investments, to meet retirement and other long-range goals. Variable annuities are not suitable for meeting short-term goals and are usually inappropriate for elderly investors because of substantial taxes, higher commissions and fees and surrender charges for withdrawing your money early. Variable annuities also involve investment risks, just as mutual funds do.**

## Learning the ABCs

### ASK QUESTIONS BEFORE YOU INVEST IN A VARIABLE ANNUITY

- ❖ Will you use the variable annuity primarily to save for retirement or a similar long-term goal?
- ❖ Are you investing in a variable annuity through a retirement plan or IRA (which would mean that you are not receiving any additional tax-deferral benefit from the variable annuity)?
- ❖ Are you willing to take the risk that your account value may decrease if the underlying mutual fund investment options perform badly?
- ❖ Do you understand the features of the variable annuity?
- ❖ Do you understand all the fees and expenses that the variable annuity charges?
- ❖ Do you intend to remain in the variable annuity long enough to avoid paying any surrender charges if you have to withdraw money?
- ❖ If a variable annuity offers a bonus credit, will the bonus outweigh any higher fees and charges that the product may charge?
- ❖ Are there features of the variable annuity, such as long-term care insurance, that you could purchase more cheaply separately?
- ❖ If you are exchanging one annuity for another one, do the benefits of the exchange outweigh the costs, such as any surrender charges you will have to pay if you withdraw your money before the end of the surrender charge period for the new annuity?



## How Do I Protect Myself From Fraud?

### *Warning Signs*

**High-Pressure Sales Techniques:** A strong, new company is not going to skyrocket in a few weeks; investment in a legitimate emerging company is long-term. If you feel pressure to make an investment decision TODAY, the opportunity is probably too good to be true.

**Blind Pools and Blank Checks:** Do not invest in any security without being told exactly how your money will be spent. Be sure you know which properties the company plans to buy with the offering proceeds and how much money is to be spent on management and promoters.

**Mismarked Trade Confirmations or New Account Cards:** Be very wary if your trade confirmation is marked “unsolicited” if your broker did, in fact, solicit the trade. While it may be a simple mistake, unscrupulous brokers often mark the confirmation as unsolicited to avoid the registration laws and the “fair, just and equitable” standard. Watch for misstatements about your net worth, income and account objectives as well.

**Unauthorized Transactions:** Be alert to placement in your account of securities you did not agree to purchase. In some instances, a broker may try to pressure you into purchasing the stock, claiming that since you have the stock, you must pay for it. In some cases, the broker is temporarily “parking” the securities in your account, perhaps to meet the minimum distribution of an IPO, or for any number of reasons. In some cases, an unauthorized trade is simply a mistake, but in any case, complain immediately, both verbally and in writing to your broker, your broker's manager and to the Securities Division.

## Learning the ABCs

### Know Your Account

After every transaction, you should receive a trade confirmation, and every month you should receive a monthly statement. Review those documents carefully and make certain that what is documented as occurring is what you intended. If you do not understand the confirmations or the statement, do not be shy about asking your investment professional to review them with you.

### Review Trade Confirmations and Monthly Statements

Trade confirmations are a source of significant information about your trade and should be reviewed carefully **immediately** upon receipt. Always check to make certain that the transaction was what you ordered.

The confirmation will state the amount of commission charged on the transaction and whether the transaction was agency or principal. No commission will show on principal transactions and on certain other transactions, particularly bonds and mutual funds. **It is important to keep in mind that, no matter how it shows on the confirmation, your broker-dealer is compensated in some fashion and you have the right to know about it.**

Always check your monthly statement to be sure that all of the securities you have with your broker-dealer are shown. As with trade confirmations, discrepancies should immediately be brought to your broker's attention. If you have difficulty reading or understanding your statements, arrange an appointment with your broker to review them.

**Tip: Keep your own complete set of records about your account, and include notes of conversations with your investment professional and any correspondence from your investment professional.**

### Top Ten Threats to Investors

1. **Senior Investment Fraud:** According to the National Center on Elder Abuse, 75 percent of fraud victims are senior citizens. Con artists tend to prey on elderly investors who have often accumulated lifetime or retirement savings. The Missouri Securities Division receives at least one complaint per week from a senior investor.

**“Senior Specialists” and “Free Lunch Seminars”** are two particular areas of concern. Individuals who refer to themselves as “Senior Advisors,” “Senior Specialists,” or other similar designations invite seniors to investment seminars that include free meals. After watching presentations, seniors are invited to attend private sessions on financial planning, taxes and insurance where they are often improperly counseled to make unsuitable investment decisions.

While the presenters may tout reputable sounding designations, these certificates are not issued by the state of Missouri or other federal regulators. Instead, these individuals use their supposed designations to create a false level of comfort among senior citizens. Many times, the only training these individuals have received is in sales techniques that target elderly citizens.

2. **Misuse of Variable Annuities:** Variable annuities are sold by investment and insurance representatives and guarantee an income stream for life. However, because they **involve market risk**, an investor may not receive the expected returns and may have to pay **large surrender charges** to access his or her money.

Also, brokers often receive higher commissions and investors are charged higher fees for annuities. Variable annuities make sense only for consumers willing to invest for 10 years or longer, but they are *not suitable for many retirees* who cannot afford to lock up their money for a long period of time. In addition, the products are so complex that many investors don't understand what they are actually purchasing.

## Learning the ABCs

3. **Unsuitable Recommendations:** Purchasing securities always includes a risk of loss. Every investment is unique and every investor has different investment goals. What may be a suitable investment for one investor may not be suitable for another. Securities professionals **must know their customers' financial situation** and refrain from making unsuitable investment recommendations. When securities professionals fail to live up to ethical standards, great harm can be done to individual investors.
4. **Affinity Fraud:** These scams **exploit the trust** and friendship that exist in groups of people who have something in common, such as **religious, ethnic, cultural or professional groups**. Con artists frequently are, or pretend to be, members of the targeted group. These con artists often enlist respected community or religious leaders from within the group to spread the word about the scheme and the leaders sometimes become unwitting victims themselves.
5. **Unregistered Individuals Selling Securities:** All individuals selling securities must be registered with the Office of the Missouri Secretary of State's Securities Division or exempt from registration. Those not registered may not be qualified to sell securities and **often fail to disclose important information**. Investors should contact the Investor Hotline at 1-800-721-7996 to check on anyone selling investments or investment advice.
6. **Unregistered Investment Products:** All investments must be registered with the Office of the Missouri Secretary of State, Securities Division or exempt from registration. Unregistered investment products have not been properly examined to ensure they are sound investments. Frequently, investments that are characterized by promises of **"limited or no risk"** and **high returns** are actually unregistered investments.
7. **Illegal Promissory Notes:** Con artists scam investors with **false promises of high returns** on what may appear to be a plausible business opportunity. Investors should be aware that even legitimate promissory notes involve risks and are marketed almost exclusively to corporate and other



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investors, who have the expertise and information to determine if the investment is a good one. Potential investors should be aware that a company's past history of paying high interest and repaying principal is not an assurance that new investors will get their money back as promised.

8. **Inappropriate Sale of “Equity Indexed” Products:** These complex investment products, which may include certificates of deposit (CDs) and annuities, offer a return that is based on a stock market index, usually the S&P 500. **Returns are not FDIC insured and are dependent on the performance of the stock market.**

A declining stock market means the possibility of no return on an investment. As a result, these products are not suitable to seniors who may need access to their money for retirement living. Equity indexed products are among the **most complex and potentially confusing in the investment industry**, and those considering such an investment should be wary.

9. **Ponzi Schemes and Pyramid Schemes:** These investment scams are essentially **“robbing one person to pay another.”** Initial investors are paid off with money taken from new investors. As long as a steady flow of new investors keeps coming in, there will be money to pay off the old investors. This early return on investment is misleading, however, because when new investors stop coming in, the scheme collapses, investors lose their money and the fraudsters walk away rich.

**Investors should contact the Investor Protection Hotline at 1-800-721-7996 with any questions regarding an investment or a broker.**

## *Learning the ABCs*

10. **Oil and Gas Scams:** Many of these scam artists play on the **news of rising oil and gas prices** to encourage investment in their phony operations. “Oil company” representatives call investors for money to start drilling on property, where oil supposedly exists. The investor gives the “oil company” money and never hears from them again.



The above ranking of the Top 10 Threats to Missouri Investors for 2006 is based on the order of prevalence and severity in Missouri and was compiled in conjunction with an annual survey of members of the North American Securities Administrators Association (NASAA).

### **What if Something Goes Wrong?**

#### *Missouri Securities Division*

The Secretary of State, through the Securities Division, is responsible for protecting Missouri investors from fraud and for ensuring firms and individuals that sell securities comply with the securities laws in the state.

The Securities Division enforcement unit investigates complaints received from Missouri investors involving alleged violations of the registration and antifraud provisions of the securities law. Staff receives more than 300 complaints from investors annually.

These investigations may result in enforcement orders, administrative actions or court orders that prohibit further violations of the law. As part of civil enforcement, the Secretary of State can seek civil penalties, victim restitution and an award for the state's investor education fund. In addition, the commissioner may refer matters for criminal prosecution to local prosecutors, the attorney general, or the U.S. Attorney.

Call the toll-free investor hotline at 800-721-7996 to report complaints or to inquire about broker-dealers, agents, investment advisers, investment adviser representatives or general securities violations.

#### *NASD and SIPC*

The National Association of Securities Dealers (**NASD**) is a national organization for broker-dealers in the United States. The NASD serves many functions both to its members and its members' customers. One of the most important functions of the NASD is the requirement that NASD members and their employees abide by the "Rules of Fair Practice." When followed, these rules are designed to ensure that securities business is conducted in a way that is "consistent with just and equitable principles of trade." The NASD takes disciplinary action against those members who violate the rules.

NASD's arbitration proceedings provide a lower-cost alternative to litigation should you have a dispute with your investment professional. However, arbitration agreements do not preclude your right to a trial should a dispute arise.

## Learning the ABCs

The Securities Investors Protection Corporation (**SIPC**) is an organization that protects investors who have money or securities in a brokerage account when the broker goes bankrupt. SIPC does not insure your investment in any way, but protects your securities or money when they are in the custody of your broker.

### Arbitration

Arbitration is a way of resolving a dispute by impartial persons who know about the areas of controversy. Arbitration of securities cases has proven to be a quicker and less expensive way to resolve disputes than lawsuits. Arbitration decisions are final, and decisions can be reviewed by a court only on a very limited basis. The arbitration proceeding must be initiated within six years or within the time required by state or federal statutes of limitation, whichever is shorter.

In an arbitration proceeding, you are not required to have an attorney, but may have one if you wish. There are usually three arbitrators, the majority of which are not affiliated with the securities industry. The arbitrators do not give a written opinion explaining their decision the way courts do, so you will not be given a reason for the decision. Although this can be unnerving to the losing party, the lack of written opinions is one of the big factors contributing to the efficiency of the arbitration system. The biggest practical difference between arbitration and the courts is that arbitrators sit in equity. That is, they resolve the dispute on what seems to them to be fair, based on the standards of practice of the investment community, the expectations of the parties when the securities transactions were made and on common sense.

#### **If Something Goes Wrong, Follow These Steps:**

- ❖ **Complain immediately to your investment professional.**
- ❖ **Follow up every telephone call complaint with a letter to confirm the matters discussed on the telephone.**
- ❖ **If you do not receive a satisfactory answer to your complaint from your investment professional, complain to the branch manager of the broker, then to the Compliance or Legal Department.**
- ❖ **If you still do not receive a satisfactory answer, file a complaint with the Securities Division.**

### **Glossary of Terms**

**Appreciation:** An increase in the basic value of an investment.

**Arbitration:** A system for resolving disputes between two or more parties who submit their disagreement to an impartial panel. Decisions of the panel are binding.

**Bear Market:** A market characterized by generally falling prices over a period of several months or years.

**Blue Chip:** Common stock of a company known nationally for the quality of its products and its profitability.

**Boiler Rooms:** Fraudulent schemes operated by high-pressure salespersons working out of rooms equipped with many telephones, offering phony investment opportunities.

**Bond:** Certificate representing a loan of money to a corporation or government for a specific period, in exchange for a promise to repay bondholders the amount borrowed plus interest.

**Broker:** A representative who handles transactions related to investors' orders to buy and sell securities.

**Bull Market:** A market characterized by generally rising prices over a period of several months or years.

**Business Failure Risk:** The risk that the business will fail and the investment will be worthless, or that a business will be less profitable than expected.

**Capital:** The wealth of a business or an individual in terms of money or property.

**Capital Gain:** The gain realized when a security is sold for more than the purchase price.

**Capital Loss:** The loss incurred when a security is sold for less than its purchase price.

**Caveat Emptor:** Latin phrase meaning, "Let the buyer beware."

**CFP:** Certified Financial Planner - an individual who has completed the educational requirements of the International Board of Certified Financial Planners (IBCFP), which covers all facets of

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financial planning, from taxes to investments.

**ChFC:** Chartered Financial Consultant - designation earned by individuals who successfully complete the financial training program offered by the American College in Pennsylvania.

**CFTC:** Commodity Futures Trading Commission, the federal regulatory agency that monitors the futures and options market.

**Commission:** A broker's or adviser's fee charged for buying or selling securities for an investor.

**Commodity:** An article of commerce or a product that can be used in commerce, such as agricultural products, metals, petroleum, foreign currencies, financial instruments and indexes.

**Common Stock:** The most basic form of corporation ownership. Owners of common stock have a claim on the assets of a company after those of preferred stockholders and bondholders.

**Compound Interest:** Interest earned on interest that is added to the principal.

**Convertible Bond:** A bond that an owner can exchange for stock before maturity.

**Coupon Rate:** Fixed annual interest rate quoted when a bond is issued.

**Deep Discount Bond:** See Zero Coupon Bond.

**Discount:** Sale of a bond at a price less than face value.

**Diversification:** Spreading investment funds among different types of investments and industries.

**Dividend:** Payment received by stockholders from the earnings of a corporation.

**Dollar Cost Averaging:** Investing the same fixed dollar amount in the same investment at regular intervals over a long period of time.

**Dow Jones Industrial Average:** Price weighted average of 30 actively traded stocks.

**Exchanges:** Marketplaces for transactions such as the New York Stock Exchange, the American Stock Exchange and the Chicago Board of Trade.

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**Face Value:** The amount a bond is worth when it matures.

**FDIC:** Federal Deposit Insurance Corporation - an agency of the federal government created to guarantee bank deposits.

**Fee:** A charge for professional services. Common fee terms are:

- a) **Front-end “load” (or asset-based charge):** May not exceed 8.5 percent of the total purchase price, and it usually serves as a commission to compensate the broker or sales agent who assisted in the purchase of a mutual fund.
- b) **Back-end charge (or contingent deferred sales charge):** The fee declines over time and is collected when you sell your shares in a mutual fund (There may also be other redemption fees).
- c) **Management fees (also called 12b-1 fees):** Such fees may be imposed by a mutual fund to cover marketing and distribution expenses of the fund. Some mutual funds have no front-end load but make up for it by imposing back-end charges and a 12b-1 fee.
- d) **Wrap fees:** Charges for an investment program that bundles or “wraps” a number of services (brokerage, advisory, research, consulting, management, etc.) together and covers them with a single fee based on the value of assets under management. Payment schedules vary, but the most common involve regular quarterly fees or individual transaction brokerage commissions.

**Financial Planner:** Person who advises others about financial issues.

**Full-Service Brokers:** People who buy and sell securities or commodities to investors and offer information and advice.

**Futures Contract:** A legal commitment to buy or sell a commodity at a specific future date and price.

**Hedging:** The process of protecting an investment against price increases.

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**Inflation:** A general rise in prices of goods and services. This reduces the purchasing power of money.

**Inflation Risk:** The risk that the financial return on an investment will lose purchasing power due to a general rise in prices of goods and services.

**Insider Trading:** The illegal use of investment information not generally known to the public.

**Interest:** For the investor, interest is the payment received from a financial institution for lending money to it.

**Interest Rate Risk:** The risk that the value of a long-term, fixed return investment will decrease due to a rise in interest rates.

**IRA:** Individual Retirement Account - a tax-deferred savings account.

**Junk Bonds:** High-risk bonds issued by corporations of little financial strength. Interest rate is high, but default rate is also high.

**Limited Partnership:** An investment vehicle formed of a general partner and limited partners.

**Liquidity:** The ease with which an investment can be converted into cash.

**Load Fund:** A mutual fund purchased directly by the public that charges a sales commission when bought.

**Margin:** A brokerage account allowing customers to buy securities with money borrowed from the broker.

**Market Price:** The price the seller will accept and the buyer will pay.

**Market Risk:** The risk that the price of stocks, real estate or other investments will go down due to business cycles or other causes.

**Mutual Fund:** A company that invests the pooled money of its shareholders in various types of investments.

**NASAA:** North American Securities Administrators Association, an organization of securities administrators charged with enforcing securities laws and protecting investors from fraudulent investments.



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**NASD:** National Association of Securities Dealers - the securities industry's largest self-regulatory organization and the parent corporation of NASD Regulation and the NASDAQ Stock Market.

**NASDAQ:** The world's largest screen-based stock market built totally out of telecommunications networks and computers.

**NASDAQ Composite Index:** Market value weighted index measuring over 5,000 NASDAQ listed common stocks.

**NFA:** National Futures Association, a congressionally authorized self-regulatory organization for the futures industry.

**No-Load Fund:** A mutual fund purchased directly by the public; does not have a charge for buying.

**Odd Lot:** A unit of less than 100 shares of stock.

**Offering Circulars:** Disclosure documents provided to investors by the company seeking capital.

**Option:** The right to buy or sell property that is granted in exchange for an agreed upon sum. If the right is not exercised after a specified period, the option expires and the option buyer forfeits the money.

**OTC (Over The Counter):** Securities that are not listed and traded on an organized exchange or a market in which securities transactions are conducted through a telephone and computer network connecting dealers in stocks and bonds, rather than on the floor of an exchange.

**P/E Ratio:** Price/Earnings Ratio - the price of a stock divided by per share earnings. A figure used to evaluate the value of a stock. Also referred to as the "multiple," that is the number of times by which the company's latest 12-month earning must be multiplied to obtain the current stock price. Obtained by dividing the current earnings into current market value.

**Penny Stocks:** High-risk stocks that generally sell for less than \$3, and are not listed and traded on any exchange or stock market. (Con artists often deal in penny stock frauds.)

**Political Risk:** The risk that government actions, such as trade restrictions, will negatively affect the price of an investment.

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**Ponzi Scheme:** An illegal investment scam named for its inventor, Charles Ponzi. Also known as a pyramid scheme.

**Portfolio:** The total investments held by an individual.

**Preferred Stock:** Ownership in a corporation that has a claim on assets and earnings of a company before those of common stockholders but after bondholders.

**Prospectus:** A document describing an investment offered for sale.

**Pyramid Scheme:** Fraudulent scheme where an investor buys the right to be a sales representative for a “product.” Those in the scheme early may profit; those joining late lose.

**Rate of Return:** A combination of yield (dividends or interest) and appreciation (increase in basic value of the investment).

**Redemption Fee:** A charge levied by the mutual fund when shares are sold.

**Return:** The total income from an investment; includes income plus capital gains or minus capital losses.

**Risk:** In an investment, the uncertainty that you will get an expected return.

**Risk Tolerance:** A person's capacity to endure market price swings in an investment.

**Round Lot:** 100 shares of one stock.

**Rule of 72:** A mathematical tool used to determine the length of time needed to double an investment at a given interest rate. The formula for the Rule of 72 is as follows: Divide the number 72 by the percentage rate you are paying on your debt, or earnings on your investment. The result is the number of years it takes to double the money.

**Securities:** A broad range of investment instruments, including stocks, bonds and mutual funds.

**SEC:** Securities and Exchange Commission - a federal agency established to license brokerage firms and regulate the securities industry.

**SIPC:** Security Investors Protection Corporation - a non-profit cor-

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poration created by Congress. Insures investors in SIPC insured firms from financial loss due to financial failure of the brokerage firm. Insures up to \$500,000 per customer.

**SRO:** Self-Regulatory Organization-securities industry regulatory bodies are under the jurisdiction of the SEC. Futures industry regulatory bodies are under the jurisdiction of the CFTC.

**Stock:** An investment that represents ownership in a company, also known as a share.

**Stock Split:** Increase in a corporation's number of outstanding shares of stock without any change in the shareholders equity or the aggregate market value at the time of the split. In a split, the share price declines.

**Street Name:** When securities are held in the name of the broker rather than the investor.

**Tax-Exempt Investments:** Investments that are not subject to tax on income earned.

**Time Value of Money:** Increase in an amount of money over time as a result of investment earnings.

**Warrant:** A type of security, usually issued together with a bond or preferred stock. The warrant entitles the holder to buy a proportionate amount of common stock at a specific price that is usually higher than the market price at the time the warrant is issued. A warrant is usually offered as a "sweetener," to enhance the appeal of the accompanying fixed-income securities.

**Yield Interest or Dividend Generated by the Investment:** Generally calculated as a percentage of the amount invested (see rate of return).

**Yield to Maturity:** The total annual rate of return on a bond when it is held to maturity, considering the purchase price, time to maturity, value at maturity and the annual dollar amount of interest earned.

**Zero Coupon Bonds:** Bonds issued for less than face value; they pay no interest income. Return to the investor occurs when the bond is sold or redeemed. Also called deep discount bonds.

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### **Contact Information**

**Office of Secretary of State Robin Carnahan**

Securities Division

800-721-7996

*www.sos.mo.gov/securities*

**National Association of Securities Dealers (NASD)**

800-289-9999

*www.nasd.com*

**National Association of Securities Dealers Regulation (NASDR)**

*www.nasdr.com*

**North American Securities Administrators  
Association, Inc. (NASAA)**

202-737-0900

*www.nasaa.org*

**U.S. Securities and Exchange Commission (SEC)**

Consumer Information Line      800-732-0330

*www.sec.gov*

**Investing Online Resource Center**

*www.investingonline.org*

### **Consumer Resources**

**American Association of Individual Investors (AAII)**

**312-280-0170**

*www.aaii.org*

**American Association of Retired Persons (AARP)**

**800-424-3410**

*www.aarp.org*

**Better Business Bureau (BBB)**

**703-276-0100**

*www.bbb.org*

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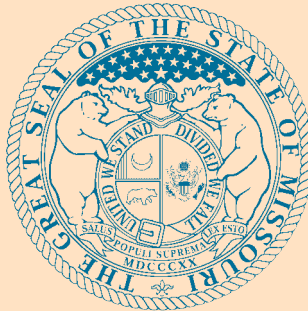
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